

RECENT AUSTRALIAN EXPERIENCE WITH THE PRIVATISATION OF GOVERNMENT SERVICES

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Abstract

In the 1990s, the privatisation of government service provision has become increasingly common in Australia. The approach taken by Australian policy-makers to the privatisation of government services has been dominated by the 'pure market' model of competitive tendering, with little recognition that this model may be inappropriate under circumstances, such as severe performance specification and measurement difficulties, which are quite commonplace in the public sector. Competitive tendering for the delivery of outcomes rather than outputs enjoys some favour in this context. A case study of government service privatisation based upon contracting for outcomes is considered. This case study (of employment assistance) helps to clarify some of the problems of outcome-based contracting.

Please note that this paper was prepared and presented in August 1998, and that the employment assistance case study represented a preliminary review of issues arising from a scheme which was at that stage very new. Since that time, the Government has made major changes to the system, in part along the lines suggested by the analysis in the paper. For example, a 'floor' or minimum bid price has been introduced, so as to prevent the lodging of unsustainably cheap bids. However, it is also the case that considerable further data on the performance of the new system has become available, and it should be noted that no attempt has been made here to analyse that data.

Introduction

This paper discusses recent Australian policy and experience with the privatisation of government services. 'Privatisation' is for the purposes of this paper taken to refer to the transfer to private entities of responsibility for the production of final services which were previously produced by government, while the term 'government services' is construed to refer to final services which are funded wholly or primarily by government rather than by the consumer.

Internationally within the public sector, the rise of economic liberalism has given rise to a desire to maximise the role of 'market'-type mechanisms and to commensurately reduce reliance upon hierarchical controls as an organisational principle (OECD, 1993). Australia is certainly no exception to this. The US 'reinventing government' movement has also been influential in Australia, although the British public sector reform model has had even more impact—not only by way of direct influence, but also as refracted through New Zealand practice (Schick, 1996; Boston et al, 1996). The concept of the purchaser/provider split is particularly fashionable within the Australian public sector at present. Australia has also been swept up in the current wave of international enthusiasm for outsourcing. The privatisation of government services is, of course, the most comprehensive form of outsourcing, in that it contracts out not merely inputs in the production process, but entire production processes.

The current wave of Australian enthusiasm for the privatisation of government services is largely a phenomenon of the 1990s. It is useful here to distinguish between service privatisations in which the contractor constructs and owns a substantial specialised asset (ie an asset with a large sunk cost), and those which do not. The first of these types of service privatisation represent a form of what is sometimes referred to as BOO (build-own-operate) contracting¹.

Australia has seen a number of BOO service privatisation in recent years. In 1992, the first privately-owned for profit 'public hospital' was opened at Port Macquarie in NSW, under a twenty year service contract with the State Government (Collyer, 1997). Victoria employed the same contracting model for a new regional hospital in the Latrobe Valley opened in 1997, and has since then called for expressions of interest by private interested in purchasing and operating a major *existing* public hospital (Bachelard, 1998). The Port Macquarie project was subjected in 1996 to a devastating critique by the NSW Auditor-General, who found that public officials had failed to negotiate a satisfactory deal, and that the Government was essentially paying twice for a facility which it would never ultimately own (NSW Auditor-General, 1996).

BOO projects have been partially driven, particularly at the state level, by a desire to avoid the public borrowing implicit in government provision. The 1990s have seen the rise in Australia of crude anti-public debt doctrines, with the adoption of debt elimination as a principle of fiscal strategy by a number of state governments and subsequently by the federal government (Robinson, 1996a). These anti-debt doctrines have given both BOO service privatisation and the sale of government business

¹ If this is taken to include BOOT (build-own-operate-transfer) projects.

enterprises an additional, albeit illusory, appeal to debt-obsessed governments. In the case of the states, this has been reinforced by the undue restrictiveness of federally-imposed borrowing constraints.

BOO projects probably represent, however, only a fraction of the rapidly increasing range of government service privatisations in Australia. Within the broader class of such privatisations a particularly interesting example is employment assistance, which is the case study discussed below. Another example is technical and further education (TAFE). Following an intergovernmental agreement in 1992, TAFE services which were formerly produced within government educational institutions have been progressively opened to competitive tendering, with private sector training bodies playing an increasingly important role (ANTA, 1997; Kell, Balatti and Muspratt, 1997). A primary aim of these reforms has been to make the industrial training system less 'supply driven' and more 'demand driven' (Moran, 1996). As of 1988, all public training funding is paid to providers chosen by consumers, under a so-called 'user choice' mechanism (Kemp, 1997).

Local government has been a sector in which service privatisation started relatively early and has proceeded relatively far. As in the US, the privatisation of relatively straightforward areas such as garbage collection was widespread well before the 1990s. More recently, however, privatisation has spread to more novel areas. In the State of Victoria, for example, under the duress of compulsory competitive tendering policies enforced by the State Government, the management of municipal libraries has in a number of instances been privatised.

Another area of extensive service privatisation in Australia has been prisons (Moyle, 1994; Harding, 1997). The first private prison opened in 1990 at Borallon in the State of Queensland, and since then an increasing number have been established throughout the country. In Queensland and NSW, government has sensibly retained ownership of the asset and has consequently confined privatisation to relatively short-term *management* contracts. Victoria, by contrast, has chosen what is essentially the BOO path, with the government consequently committed to twenty year service contracts (Victorian Government, 1996: 88). Australian experience with privatised prisons is rather mixed. Some (such as Borallon) have apparently operated reasonably well. Others have experienced serious performance difficulties. Perhaps the worst problems have been experienced in Victoria, where the new Port Phillip private prison has experienced high suicide rates, riots and a range of other serious problems. Inadequacies in the performance monitoring regime appear at least partly to blame.

The Market Model

The current Australian 'conventional wisdom' about the privatisation of government services is characterised by, firstly, a pervasive belief that there are few if any limits to the appropriate extent of such privatisation and, secondly, by an adherence to a very particular model of how it should occur.

Advocates of the notion that government should largely remove itself from the production of the services which it funds are spread widely throughout the bureaucracy and within the Coalition, and are also to be found within the Labor Party.

The National Commission of Audit, which in 1996 produced a blueprint for public sector reform at the behest the incoming Howard Government, affirmed that 'governments as far as possible should operate as funders of programs, with funding separate from the actual delivery of the services involved' (Officer, 1996: viii), and one influential Coalition-aligned political consultant has even announced the arrival of an era of 'virtual government' (Sturgess, 1994: 45). By contrast, amongst those who sense that there are major limits to the privatisation of government services, there tends to be an inability to adequately articulate the nature of those limits.

The model of contracting upon which Australian enthusiasts of government service privatisation and of marketisation more generally base their thinking is one which involves the government contracting with provider entities for the supply of clearly defined goods or services at a specified price. The idea is that by focusing on deliverables, the contract should free government of any concern with the inputs and processes to be used by the provider. Supply arrangement, it is held, should be as competitive as possible. This will generally mean that a transparent competitive tendering process should be employed to select the provider, and that re-tendering should occur at relatively frequent intervals so as to maximise competitive pressure (eg Industry Commission, 1996; Reith, 1996; Queensland Treasury, 1996; FitzGerald, 1996, vol 1, pp 65-68). The only generally acknowledged (partial) exception to this model in current Australian public sector practice is in the case of BOO-type projects, where the long-run nature of the capital investment obviously makes long-term operating contracts unavoidable.

While this model does not necessarily rule out tendering by non-profit entities, the emphasis is upon harnessing the profit motive to drive performance, rather than upon drawing upon the altruism of community-minded individuals and organisations.

This model of the purchaser/provider transaction gives maximum play to the competitive price mechanism, and may be referred to as the 'pure market' model. It represents a form of what the organisational economist Oliver Williamson refers to as 'classical' contracting. The obvious inspiration of the pure market model is elementary economics. It has, however, obvious synergies with the idea of management focused upon outputs and outcomes rather than inputs—an idea which may be traced back at least as far as the program budgeting movement (Robinson, 1996b)².

Two closely-related central issues arise. Firstly, to what extent and under what circumstances is the pure market model feasible and effective mode of contracting between government and private sector service providers? Secondly, what—if any—are the limits to service privatisation?

Organisational economics points to two important criteria for determining whether a particular transaction is well suited to 'pure market' contracting. One of these is asset specificity, and the other is the existence and severity of performance specification

² 'Outputs', of course, refer to the actual services provided, whereas 'outcomes' refers to the intended result of providing those outputs. In a standard example, a measles vaccination is an output, whereas a reduced incidence of measles is an outcome.

and measurement problems (Williamson, 1985)³. Asset specificity takes a number of forms, including specificity of physical assets of the type referred to above in respect to BOO projects. In terms of performance specification and measurement, if the type and quality of the service to be provided can be clearly specified in the contract, and provider compliance with the terms of the contract is, consequently, capable of unambiguous verification without undue cost, then there are no performance measurement/specification impediments to ‘pure’ market contracting. There are certainly a variety of government services which meet these criteria, and which are consequently well-suited to classic competitive tendering⁴. Garbage collection and franchised bus routes are two good examples. It is, however, well known that severe output specification and measurement problems are particularly widespread within the public sector. The greater the magnitude of such problems, the more scope there is for potential suppliers to misrepresent the quality of the service they are offering to provide and then, having won a contract, to compromise quality and get away with it. Profit-maximising contractors may have incentives to behave in this manner even in the absence of fierce competition. A climate of intense price competition may, however, *force* them to cut costs by sacrificing quality in order to keep in business. In respect to certain government services, moreover, central Government may not know which precise outputs are needed to achieve the outcomes it has in mind. Acute hospital services are a classic example. Employment assistance (see below) is seen by Australian government policy-makers as another.

One implication of these informational problems is simply that in many instances internal production will be more efficient than outsourcing. As Williamson points out (1985: 154-5), internal production has a number of advantages including more effective performance monitoring and greater flexibility of contractual adaptation. In the absence of serious performance measurement difficulties (or asset specificity problems) come into play, these advantages of internal production will be offset by the motivating power of market performance incentives—but not otherwise.

A further implication is that, if outsourcing is to take place, the competitive tendering model will in many instances not be the best contractual *modus operandi*. Both theoretical considerations and US experience (Propper, 1993; DeHoog, 1990; Mann, McMillin, Rienzi and Eviston, 1995; Milward, 1994; Kettl, 1993) indicate that, in the presence of serious performance specification/measurement problems, both purchaser and provider have a strong interest in maintaining continuity in the relationships rather than transacting their business as a series of no-commitment competitive tendering ‘one night stands’. One reason for this is that the true quality of a provider can often only be judged after the efflux of some time, giving government a strong incentive to retain the services of any provider whom it has come to believe may be relied upon to do a good job. When, moreover, new providers must climb a ‘learning curve’ in order to attain full competence in providing the service concerned, this need for continuity is reinforced by a form of human asset specificity. Moreover, notwithstanding the fashionable rhetoric about the desirability of focusing exclusively upon outputs and/or

³ Economies of scale and scope are, of course, the other key consideration in the internal production vs outsourcing decision.

⁴ Competitive tendering will, moreover, tend to have wider applicability in the provision of *inputs* to the public production process, because these will often be readily easily specified and measured.

outcomes, the presence of significant specification/measurement problems often means that it makes sense for government to interest itself in the inputs and processes employed by the supplier, as proxies for quality (eg Mann, McMillin, Rienzi and Eviston, 1995).

One idea which has become fashionable in recent times in Australia is the notion that, by contracting for the delivery of outcomes rather than outputs, it may be possible to overcome some of these contracting difficulties. Perhaps the boldest Australian experiment with outcome-based funding is taking place at present in the privatised provision of employment assistance.

Privatisation of Employment Assistance

‘Employment assistance’ refers to jobs information/matching services and to other labour market programs designed to assist unemployed people into jobs and off government income support. Traditionally, employment assistance in Australia was provided predominantly by a government body, the Commonwealth Employment Service (CES), with some funding of services provided by non-profit private sector bodies. In 1998, a radically new ‘FLEX’ scheme initiated by the Coalition Government has come into operation, as the central part of a so-called Job Network scheme (Vanstone, 1996). Under FLEX, all service provision is awarded by competitive tender—including any market share which might be won by a new government service provider, Employment National. Approximately seventy percent of work has gone in the first contract period to private sector providers, from both for-profit and non-profit sectors (Trinca, 1998; Dore, 1998). Another key feature of the scheme is considerable client choice of provider.

Three categories of assistance are provided under FLEX: Job Matching, Job Search Training, and Intensive Assistance. Intensive Assistance is a catch-all for a range of forms of assistance which may be provided to the *long-term* unemployed⁵, including various types of remedial training, psychological assistance, and, at least in principle, temporary wage subsidy arrangements (DEETYA, 1997c: 81).

The FLEX scheme was not the first step in the privatisation of employment assistance. In the early 1990s, the then Labor Government had introduced the principle of ‘case management’ into employment assistance for the long-term unemployed. Case management is a health sector concept, and involves each client being assigned to a case manager who manages their case and selects the services with which they are provided. Initially, this function was carried out exclusively by the CES. In 1994, Labor decided to open case management services to what it described as ‘healthy competition’ from the private sector (Keating, 1994). This system commenced operation in 1995, and was still in its infancy when it was superseded by FLEX.

The influence of the pure market model upon the design of FLEX is pervasive. The emphasis is strongly upon *price* competition. Job Matching⁶ and Job Search Training

⁵ An additional group of clients, deemed to be in danger of becoming long-term unemployed, is in fact also eligible for Intensive Assistance services.

⁶ Apart from the outcomes component of the payment, which is (initially at least) fixed.

contracts have been awarded on a 'price-competitive basis', which means that bids are first judged to be either 'suitable' or unsuitable, and those judged suitable are then 'ranked according to price' (DEETYA, 1997c: 4). Although the Government has set fixed prices for Intensive Assistance in the first tender round, this arrangement is purely transitional. From the second tender round, *all* services are to be tendered on a 'price-competitive basis' (DEETYA, 1997a: 11). The duration of the contract is also relatively short: eighteen months in the initial round, with an expectation of approximately three years in the second round and beyond.

This move towards a system based primarily upon price competition represents a step into the unknown. Under the previous case management system, prices had been fixed by government and tender competition was confined to quality. This was widely viewed as a temporary arrangement, but there was in fact inter-departmental controversy about how far and in what manner price competition should be developed within the case management system (Auditor General, 1996b). This controversy was clearly related to the existence of substantial *ex ante* quality measurement difficulties (Auditor General, 1996a), and to the presence of a significant 'learning curve' effect amongst providers (ESRA, 1997: 40, 44).

Also consistent with the model of pure market contracting is a major reduction in the input and process regulations governing provider agencies under FLEX (Stuart and Thorsen, 1997). By way of comparison, the case management scheme had been managed on the premise that 'competitive tendering alone would be insufficient to produce speedy improvements in quality and performance' (ESRA, 1997: 12). Case management providers were therefore subject to a series of health sector-inspired quality assurance measures, including an accreditation process and a 'practice improvement program' (ESRA, 1997: 22, 33-35). Under FLEX the accreditation process has been abolished, and quality-related process requirements have been limited to privacy matters and complaints handling. There is a Code of Conduct for providers (DEETYA, 1997b: 51), but it is for the most part highly general in nature. This is perhaps hardly surprising given that the Code was not part of the original scheme design, but was added subsequently to counter public criticism of the abolition of accreditation requirements (Senate, 1997, ¶3.39-¶3.43).

The most striking feature of this new scheme is that provider remuneration is quite heavily weighted to *outcomes*. Intensive Assistance is the most cost-intensive service, and potential provider remuneration-per-case (of up to approximately \$9,000) reflects this. Sixty-five percent of this potential remuneration is contingent upon outcomes, meaning that this amount is payable to providers only if and when an eligible client (basically an unemployed persons who is in receipt of government income support) is placed in a job. The remaining thirty-five percent taking the form of an 'up-front' payment (DEETYA, 1997c: 13). Previously extant government-funded labour market programs have been abolished, as a consequence of which the government now no longer produces or purchases the specific outputs which comprise Intensive Assistance⁷. The provider agencies both select and pay for whatever services they provide to clients—either producing those services themselves, or purchasing them from others. The only constraint on the freedom of provider agencies to choose

⁷ With the exception of job search training, as described below.

whatever services they believe are most appropriate for the client is a requirement that the provider agency enter an 'activity agreement' with each client in which the services to be provided to that client and that an official of the relevant Government department approve that agreement (DEETYA, 1997b: 28-9).

Payments for Job Matching are, similarly, comprised of an outcomes component and an up-front component. The outcomes component was fixed in the first round by the Government at \$250. The up-front component has been the subject of (aggressive) price competition, and information about the per-case amounts tendered by successful bidders is commercial-in-confidence. Industry sources suggest, however, that the average may be around \$200, with some perhaps as low as \$100. The resultant heavy weighting of outcomes in Job Matching remuneration would, therefore, appear to be in part the consequence of a tendering framework which placed too much emphasis upon price and too little upon quality, permitting some rather dubious operations to win business at low prices.

Only in respect to the Job Search Training element of FLEX has there been no attempt to place remuneration on an outcomes basis. Agencies are paid per episode of training (ie on an output basis), although subsequent success in job placement the Job Matching outcome payment.

The Rationale for Focusing upon Outcomes

Why the extent of this emphasis upon outcomes, and corresponding de-control of outputs? Clearly, there are significant quality specification and measurement problems which would need to be addressed if government contracted with provider agencies to provide outputs⁸. However, in respect to Intensive Assistance, the more specific reason for the outcomes focus in respect to employment assistance is a Government view that as a 'purchaser' it is not well placed to judge which particular forms of employment assistance are most likely in any particular case to achieve the outcomes they have in mind. From this perspective, government control of outputs—whether achieved through output-based contracting with an external provider or through directives to a government service entity—must necessarily result in significant allocative inefficiency. Government policy-makers believe that employment assistance in Australia has in the past been too 'program driven', with clients at times being allocated to specific programs not because of a careful judgement that these were the programs most likely to be of benefit to them, but simply because there were places available (eg, Committee on Employment Opportunities, 1993).

In this view, those who produce the service are in a better position to know what services are most likely to benefit individual clients. The challenge therefore is somewhat like that faced in the health sector: how does one endow service providers with the flexibility to tailor services while ensuring that such flexibility is not abused through inappropriate or excessive servicing. Outcomes-based funding is the chosen solution. It may be inferred that the Government believes that if those who select the services also pay for them, and are only remunerated for success in placing clients in

⁸ These problems can, indeed, be expected to arise in respect to Job Search Training

employment, there is no incentive for over-servicing or for the ‘shaving’ of service quality.

Scheme Difficulties

In 1997, Prime Minister Howard forecast that within three months of its operation, the FLEX scheme would be seen as an enormous success. This is not quite how things have worked out. At the time of writing (mid 1998), this three months has elapsed and FLEX is widely perceived to be in a state of acute crisis, to the great embarrassment of the increasingly embattled Coalition government. Job placement rates appear to be well down relative to the previous system (Mitchell, 1998), and many provider agencies appear to be on the brink of bankruptcy. The flavour of press coverage can be gauged from some typical headlines: ‘Anger as Jobs Scheme Problems Grow’; ‘Work Seekers’ Verdict on Job Network: It’s a Flop’; and ‘Job Network Agencies Struggling to Survive’.

Job Matching services are experiencing the most immediate difficulties. Many agencies are complaining that remuneration for this service is quite insufficient. Client referrals from government are also said to be far too slow. There are, moreover, considerable problems arising from the termination of the previously free service for both employers and for the large portion of unemployed persons who are ineligible for government-subsidised assistance because they are not in receipt of government income support.

Of course, with only three month’s operation, the FLEX scheme is far too new for definitive conclusions to be drawn. It is too new even to embark upon systematic survey work: this would have to wait until the scheme has settled down somewhat. This, however, may never happen. At the time of writing, there are indications that the Government, which faces an imminent election, may be on the brink of announcing radical changes to the scheme. It nevertheless seems useful to consider from the perspective of ‘first principles’ some of the problems which FLEX is currently faced and may be expected to face in the future.

Risk and Uncertainty in a Regime of Outcome-Based Remuneration

It is well recognised in the agency theory literature that, whatever the incentive effects of payment-by-results, a major limitation upon the use of this mode of remuneration is the degree of risk⁹ in the relationship between an agent’s effort and the consequent results (eg Besanko, Dranove and Shanley, 1996: 630-633). In the case of public programs, the degree of risk pertaining to outcomes tends to be particularly large. Economic principles suggest, firstly, that to the extent that contracted service providers are paid for outcomes, the higher the degree of uncertainty and risk, the greater the (statistically) expected provider remuneration will need to be. More importantly, they suggest that, if providers are more risk-averse than government, it will not be optimal to allocate most risk to providers (Aoki, 1984).

⁹ ‘Risk’ is used loosely here so as to include Knightian uncertainty.

Job Matching outcomes are certainly subject to significant risk. There is a certain irreducible processing effort required for each client, yet the probability of placing clients in jobs is heavily dependent upon the state of the macro-economy. Uncertainty about rates of client referral to providers by government has also been a problem when there are fixed operating costs to be covered.

There is, however, considerably more risk again in the effort/outcomes relationship for Intensive Assistance services, which are much more costly to the service provider than Job Matching. Every time a provider spends more on an Intensive Assistance client than the ‘up front’ payment it receives, it is making an investment in respect to which it will not even recover its costs (let alone make a profit) unless an employment outcome is achieved. There is significant risk concerning the prospects both of achieving the desired intermediate outcome of such services (eg improved client employability), and of then achieving the high-level outcome of a successful job placement. One implication of this is that, during recessions, agencies may be very reluctant to spend much beyond the minimum level covered by the up-front payment. A further implication is that, even in a more buoyant and stable macroeconomic environment, it is likely that there will be a sub-optimal level of expenditure on such assistance because provider agencies will generally be *much* more risk-averse than government. This is particularly true of non-profit providers and of smaller provider agencies from disadvantaged regions, both of which tend to be short on working capital.

Providers are contractually obliged to accept and provide services to all appropriately-referred Intensive Assistance clients. They are also required to achieve targets related to the demographic profile of their placements, so as to ensure that equity groups are adequately catered for (DEETYA, 1997b: 23). These requirements are designed to prevent providers from managing their risk exposure by selecting clients who are most easy to place and rejecting or under-servicing those with relatively poor job placement prospects. This exemplifies a further problem of outcomes-based remuneration which is perhaps unique to the public sector. In those areas where payment-by-outcome is employed within the private sector, service providers typically manage risk by being highly selective in choosing clients. A classic instance is the provision of litigation services on a contingency basis (‘on spec’)—clients without high prospects of winning their court case simply cannot obtain this service. The problem is that in the public sector such selectivity is apt to be regarded as unacceptable ‘cream-skimming’. In the case of employment assistance, not only are there specific equity targets, but there is politically-induced ambiguity about the extent to which providers can expect the government to reduce their risk by at least ‘weeding out’ (subject to the equity targets) the hard-core unemployable individuals who have in the past constitutes such a problem for labour-market programs (Kelly, 1997: 345).

To the extent that they are actually effective, non-price measures to prohibit cream-skimming, such as an obligation to accept all referrals, simply increase provider risk. In practice, however, providers are likely to respond by minimising the services they provide to Intensive Assistance to clients whom they judge least likely to obtain work. The only constraints upon this type of behaviour appears to lie in the general contractual stipulation to provide a quality service, and in the requirement that the ‘activity agreement’ be officially approved. It seems fair to predict that this approval

requirement may become a major stress point in the new system. One possibility is that it will emerge increasingly as a vehicle for the de facto re-imposition of output controls.

An obvious price-based measure to address this problem is a differentiated outcomes fee structure which relates the amount of the payment to the difficulty of the case. FLEX in fact has such a fee structure, as did the former case management system. The classification of clients is, however, an unavoidably crude business. While, moreover, client-differentiated fees somewhat reduce the degree of risk related to variable client characteristics, they do nothing about other crucial dimensions of risk such as the state of the economy.

Underlying these grave concerns about the ramifications of high levels of provider risk under the FLEX scheme is a more fundamental issue about the government's motivation. The Coalition regards many of the labour market programs formerly provided by government as ineffective and wasteful. This applies particularly to wage subsidy programs and temporary public employment schemes (a view strongly challenged by recent independent research (Stromback, Dockery and Ying, 1998)). An interesting question is therefore whether the public rhetoric about flexibility and individual tailoring is a true reflection of the Government's motivation, or whether perhaps the desire to see a major reduction in expenditure on these forms of assistance may not loom larger in the Government's thinking. It is perhaps significant in this context that outputs-based funding for Job Search Training—a low-cost form of assistance with which the Government is comfortable—has been retained.

Outcome Specification and Measurement Issues

Given that there is necessarily much greater risk and uncertainty in the relation between effort and outcomes than in the relation between effort and outputs, outcomes-based contracting can only possibly be superior to outputs-based contracting if specification/measurement problems are much less severe in respect to outcome than in respect to outputs. Employment assistance is, in this respect at least, considerably more conducive to outcomes-based contracting than many other human services. Job placements are relatively unproblematic to measure and yet may be considered to be a reasonably high level outcome indicator. Notwithstanding this, they are not a perfect outcomes measure, and can consequently be expected to induce certain behavioural distortions.

While to some the desired high level outcome of employment assistance to the long-term unemployed is increased aggregate employment, many others take the view that employment assistance does not in general influence aggregate employment and that the real objective of employment assistance should in fact be labour market equity (Stretton and Chapman, 1990; Kirby, 1985). To the extent that equity towards specific disadvantaged groups within the general pool of long-term unemployed (such as ethnic minorities and the disabled) is a key objective, mere numbers of job placements are an inadequate performance indicator. The composition of placements will also be important. This makes it clear that the 'cream-skimming' issue discussed above may also be viewed as an outcome specification problem.

There is a coercive element in the provision of employment assistance which is essentially unique to the public sector. Client co-operation with the provider is a precondition for the continued receipt of social security support. When providers are paid primarily by outcomes, there is a danger that the financial incentive to place client in jobs may lead to undesirable *procedural* outcomes, such as the pressuring of clients to accept jobs which are unsuitable and which they are by law entitled to refuse without losing government income support. Australia's Commonwealth Ombudsman (1997: 2, 64-6) has described the growing incidence of 'process corruption' of this type as a result of outcomes-based remuneration of contractors, citing the former case management system as one of a number of problem areas. If such process corruption was a problem under case management, it can reasonably be expected to be even more of a problem under the FLEX system, where the incentives to achieve placements are so much greater. The rather general injunctions against such behaviour in a new *Code of Conduct* certainly do not appear adequate to deal with this problem.

Conclusions

This case study of employment assistance privatisation is illustrative of the manner in which recent Australian public sector practice in government service privatisation and outsourcing more generally has tended to be dominated by the simple 'pure market' model. Yet in the presence of major performance specification/measurement problems, or given other forms of asset specificity (in particular, human asset specificity), this mode of contracting may be quite inappropriate. As the OECD (1993, p 92) noted in its recent report on the use of market-type mechanisms within the public sector:

In the private sector, contractual relationships run the full gamut from "pure market" (ie arms length transactions for very specific jobs, making repeated and maximum use of competition to obtain the best prices) to partnerships with suppliers involving a lot of trust, sophisticated harmonisation procedures, wide sharing of information, relatively long-term commitments cemented by client-specific investments, mutual shareholdings, and so on. Somewhat paradoxically, standard [public sector] procedures in most countries tend to locate the options of contract managers to the "pure market" end of the spectrum

For many government service, contracting based upon outputs raises significant quality measurement problems. In addition, in instances of significant information asymmetry, it may be quite undesirable for central government authorities to determine which specific outputs are to be provided. In the case of employment assistance, the Australian government has attempted to overcome these problems by weighting outcomes very heavily in provider remuneration under the FLEX scheme. However even though the measure of high-level employment assistance outcomes which has been used for this purpose is much less imperfect than are outcome measures for many other public programs, the extent of this emphasis upon outcomes has been the source of enormous program difficulties. The primary reason for this is the considerable risk and uncertainty governing the relationship between provider effort and high-level outcomes. These problems are so severe that, at time of writing, it appears likely that the government will radically revise the FLEX scheme after only a few months of operation.

This is not, of course, to suggest that some element of outcomes-based remuneration may not often be a desirable feature of contracting for privatised government service provision. Outcome-based performance bonuses, for example, are often a useful mechanism. However, it is important that provider risk be kept to acceptable levels. In the case of employment assistance, one potentially attractive strategy might have been to maintain the former case manager/service provider distinction, while making case managers 'fund-holders'. This would have meant giving case managers substantial power to allocate *government* (rather than their own) funds to purchases services their clients. Such an approach would have given case managers considerably for more control over the outputs provided to their clients, while greatly moderating the degree of provider risk exposure inherent in the outcomes component of provider remuneration. However, it is not yet possible to state with confidence that privatised service provision on this or some other model is in fact superior to internal government provision.

In Australia at least, there is a need for considerably more thought to be given to appropriate contracting models and, more generally, to the full range of relevant criteria for selecting between internal production and outsourcing. The 'pure market' model is clearly dangerously limited. It is, for example, quite wrong to think that outsourcing is only appropriate when it is possible to structure a 'competitive' market in which a significant number of potential providers compete via tender in the manner of a textbook model of perfect competition. Outsourcing may potentially be useful even under circumstances such as bilateral monopoly, for reasons which are not made explicit by the competitive tendering model. On the other hand, outsourcing may be entirely undesirable even when multiple service providers are willing to compete for the business. What is necessary is that public policy makers leave behind simplistic textbook notions of the manner in which 'markets' work, and develop a more sophisticated appreciation of the range of potential modes of contracting from which they might choose.

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